STATE OF MICHIGAN

COURT OF APPEALS

GEAR RESEARCH, INC., Petitioner-Appellant,	UNPUBLISHED June 18, 1999
v	No. 207207 Tax Tribunal
DEPARTMENT OF TREASURY, Respondent-Appellee.	LC Nos. 227850; 239890

Before: Markey, P.J., and McDonald and Fitzgerald, JJ.

PER CURIAM.

Petitioner appeals as of right the opinion and order of the Tax Tribunal denying its petition to exclude certain sales made to customers in foreign states from the single business tax apportionment formula and requiring petitioner to pay its revised single business tax assessment. We reverse and remand.

Petitioner, a Michigan corporation, sells precision gears used in the floor care industry to customers within Michigan and in other states. According to testimony presented at the tribunal's hearing, petitioner had approximately 144 out-of-state accounts spread among some seventeen states. Petitioner's sales representatives testified that they would conduct quarterly sales visits to these out-of-state customers in an attempt to gain new customers and make new sales to existing customers. Petitioner's president would sometimes accompany petitioner's sales representatives on these out-of-state visits in order to foment customer good will and increase sales. Further, petitioner's sales representatives attended trade shows in sales destination states, where they would solicit further business. Petitioner also maintained an independent sales representative who solicited sales in New York and New Jersey and maintained an office in New York City.

Petitioner consistently calculated overpayments of its single business tax on its single business tax returns for tax years 1989 to 1995 as a result of excluding sales made to customers in other states from the apportionment formula used to calculate single business tax liability. The nature and level of petitioner's activity in other states in which it makes sales is important to its single business tax liability because sales made to customers in states where petitioner "is not taxable" are considered to be

Michigan sales for the purpose of that tax. MCL 208.52(b); MSA 7.558(52)(b). To avoid tax liability for sales, it is not necessary that petitioner be actually taxed for sales made to customers in another state; the statute considers petitioner to be taxable in another state if "that state has jurisdiction to subject the taxpayer to . . . taxes regardless of whether, in fact, the state does or does not." MCL 208.42; MSA 7.558(42). Thus, because petitioner believed itself to be taxable in states other than Michigan in which it sold its products, petitioner excluded its foreign sales from its single business tax liability.

Respondent, however, disagreed with petitioner's calculation of its single business tax liability in the tax years 1989 to 1995 and included petitioner's out-of-state sales in the single business tax apportionment formula. Respondent eliminated the overpayments that petitioner had calculated on its tax returns for the tax years at issue, and issued assessments for single business taxes owed, plus penalties and interest, against petitioner. Petitioner filed the instant petitions against respondent for restoration of the single business tax credits it claimed on its tax returns from 1989 to 1995.

After hearing the evidence, the tribunal found that petitioner's sales in New York and New Jersey should not have been "thrown back" to Michigan for single business tax purposes because petitioner maintained a permanent, full-time independent contractor who was responsible for sales to customers in New York and New Jersey. However, the tribunal found that respondent was correct in "throwing back" to Michigan for single business tax purposes sales that petitioner made in Arkansas, Illinois, Florida, Massachusetts, Indiana, Ohio, Wisconsin, and Minnesota.

On appeal, petitioner argues that this Court should reverse the tribunal's decision because it was affected by a substantial and material error of law. We agree.

In the absence of fraud, this Court's review of the Tax Tribunal's decision is limited to whether the tribunal erred in applying the law or adopted a wrong principle; the tribunal's factual findings are conclusive if they are supported by competent, material, and substantial evidence on the whole record. *Michigan Bell Telephone Co v Dep't of Treasury*, 445 Mich 470, 476; 518 NW2d 808 (1994).

Section 9 of the Single Business Tax Act ("SBTA"), MCL 208.1 *et seq.*; MSA 7.558(1) *et seq.*, determines a taxpayer's single business tax base. MCL 208.9; MSA 7.558(9). Section 41 of the SBTA, MCL 208.41; MSA 7.558(41), requires a taxpayer whose business activities are taxable both within and without Michigan to apportion his tax base as provided in Chapter 3 of the SBTA, which requires the multi-state taxpayer to use an apportionment formula that compares sales made, property owned, and payroll paid by the taxpayer in Michigan to the sales, property held, and payroll paid by the taxpayer everywhere else. MCL 208.45; MSA 7.558(45). The sales factor of the apportionment formula "is a fraction, the numerator of which is the total sales of the taxpayer in [Michigan], and the denominator of which is the total sales of the taxpayer everywhere during the tax year." MCL 208.51; MSA 7.558(51). For the purpose of applying the SBTA, sales of tangible property are considered to take place in Michigan if (1) "the property is shipped or delivered to a purchaser, other than the United States government, within [Michigan]," or, (2) "[t]he property is shipped from an office, store,

warehouse, factory, or other place of storage in [Michigan] and the purchaser is the United States government, or the taxpayer is not taxable in the state of the purchaser." MCL 208.52; MSA 7.558(52).

"To avoid [Single Business Tax Act] liability for sales, it is not necessary that plaintiff be actually taxed for sales made to customers in another state; the statute considers plaintiff to be taxable in another state if 'that state has jurisdiction to subject the taxpayer to . . . taxes regardless of whether, in fact, the state does or does not.' MCL 208.42; MSA 7.558(42)." *Magnetek Controls, Inc v Dep't of Treasury*, 221 Mich App 400, 404; 562 NW2d 219 (1997). Therefore, the key issue to be addressed when deciding whether to "throw back" to Michigan sales made in other states for the purpose of determining tax liability under the Single Business Tax Act is whether the other state *could* impose a tax on the sale of the Michigan product within its borders. The Commerce Clause of the United States Constitution significantly limits the sales destination state's power to tax such a transaction. While the Commerce Clause empowers the United States Congress to "regulate Commerce . . . among the several States," US Const, art 1, § 8, cl 3, "it has a negative sweep as well," which prohibits certain state actions that interfere with interstate commerce. *Quill Corp v North Dakota*, 504 US 298, 309; 112 S Ct 1904; 119 L Ed 2d 91 (1992). Pursuant to the four-part test set forth by the Supreme Court in *Complete Auto Transit, Inc v Bradley*, 430 US 274, 279; 97 S Ct 1076; 51 L Ed 2d 326 (1977), a state tax can survive a Commerce Clause challenge so long as it "[1] is applied to an activity with a substantial nexus in the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." See *Magnetek*, *supra* at 406.

This case concerns whether petitioner, by virtue of its economic relationships with its customers in other states during the tax years at issue, established a physical presence within those other states sufficient to satisfy the "substantial nexus" requirement of the *Complete Auto Transit* test. To establish the requisite constitutional nexus, a taxpayer must show that its physical presence within the other state was more than a "slightest presence." *Quill*, *supra* at 315 n 8; *Magnetek*, *supra* at 408. This can be established by maintaining "a small sales force, plant, or office" in the other state. *Quill*, *supra* at 315; *Magnetek*, *supra*. However, there is no requirement that the physical presence within the other state be substantial. *Id.* at 410. In *Magnetek*, *supra* at 411, this Court adopted the substantial nexus test as enunciated by the Court of Appeals of New York in *Orvis Company, Inc v Tax Appeals Tribunal of the State of New York*, 86 NY2d 165, 178; 654 NE2d 954 (1995), which provides:

> While a physical presence . . . is required, it need not be substantial. Rather, it must be demonstrably more than a "slightest presence" . . . [a]nd it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf.

Thus, as this Court explained in *Magnetek*, *supra* at 411-412, there is no requirement that the taxpayer maintain a sales force that continuously solicits sales in the sales destination state. Much less

physical presence within the sales destination state can suffice to fulfill *Quill*'s substantial nexus requirement. For example,

> [a]pplying this standard to the cases before it, the Court in *Orvis* determined that a Vermont wholesaler whose salespeople came into New York to visit nineteen customers an average of four times a year had sufficient physical presence in New York to be susceptible to the imposition of tax obligations by the state of New York. *Id.* at 180. The same was true for a second taxpayer before the court, a mail-order computer equipment supplier that had sent troubleshooting consultants into New York on forty-one occasions during the three-year audit period at issue. *Id.* at 180-181. [*Magnetek*, *supra* at 411.]

Similarly, this Court found that the *Magnetek* plaintiff had established more than a "slightest presence" in states for which the plaintiff sought Single Business Tax relief because, as pertinent,[1] the plaintiff sent its salespeople into the sales destination states to meet with its independent sales representatives located in those other states

> to give them feedback and suggestions, especially to improve sales; to conduct seminars for groups of potential customers assembled by the independent sales representatives; to update the independent sales representatives concerning current information and new applications regarding plaintiff's products, as well as sales and marketing techniques plaintiff had found effective; and to accompany the representatives on calls to specific customers, often giving the sales presentation to the potential customer themselves. [*Id.* at 403, 412.]

Moreover, the plaintiff also sent its sales managers and other employees to trade shows in other states, where they went to "cultivate new customers, answer potential customers' questions, and assess [the] plaintiff's competition" and where the plaintiff's employees would "also call upon customers located in that state." *Id.* at 403-404.

Turning to the instant case, we agree with petitioner's contention that the tribunal misinterpreted the *Magnetek* decision as requiring a minimum of two weeks of solid sales effort in sales destination states in order to establish a substantial nexus with those states that would justify the imposition of taxes by the destination states. The tribunal stated:

> Furthermore, the Tribunal does not find solicitation, to the *Magnetek* degree, in any of the other foreign states, except New Jersey and New York, in which Petitioner's products were sold. According to *Magnetek*, sales activities standing alone can suffice to establish a substantial nexus, depending on the level of physical presence involved. *Petitioner maintains no office, no plant and has no other property interest in any of these foreign states. Furthermore, Petitioner's employees' sales effort did not constitute at least two weeks of solid effort. According to the Magnetek standard,*

> *these activities do not amount to more than a "slightest presence" in the other states*. Petitioner's sales activity followed by a two to four day visit by the company President does not constitute a sufficient physical presence to establish a nexus with the aforementioned states. [Emphasis added.]

This passage evidences the tribunal's mistake of law and adoption of an incorrect legal standard. First, the tribunal misread *Magnetek* as requiring a minimum of two weeks of "solid sales effort" in order to show a substantial nexus with the sales destination state. While the *Magnetek* Court found it significant that the plaintiff had exerted "two weeks' worth of solid sales effort in other states," *id.* at 409, it did not attach talismanic importance to the fact of the plaintiff's continuous sales efforts, nor did it purport to adopt a "two week standard" as a minimum, quantitative test for applying *Quill* to the facts of a given case. Indeed, the *Magnetek* Court credited the Court of Appeals of New York's understanding of *Quill* as correct, and thus impliedly acknowledged that the activities in New York of the two taxpayers in *Orvis*, which fell far short of "two weeks' worth of solid sales effort," were sufficient to establish substantial nexuses with New York for the purpose of taxation. *Magnetek*, *supra* at 411. Thus, the tribunal erred in attaching any significance to the fact that petitioner failed to show that it performed two weeks of solid sales efforts in the destination sales states and, as evidenced in its opinion, misconstrued the substantial nexus test as adopted by this Court in *Magnetek*.

Second, the *Magnetek* Court did not hold that sales activities in the form of sales solicitations were necessary to manifest more than a slightest presence in a destination sales state. Rather, "*economic activities* in the taxing State performed by the vendor's personnel or on its behalf" are necessary to demonstrate more than the slightest presence in a foreign state. *Id.* at 412 (emphasis added). While "economic activities" will most likely be cognizable as traditional sales solicitations in a given context, they may also be simple "good will visits" conducted by representatives of a vendor or its employees. For instance, in *Orvis*, *supra*, 86 NY2d 170, 180-181, one of the taxpayers, Vermont Information Processing, Inc. ("VIP"), a computer hardware and software vendor, delivered most of its merchandise to New York by common carrier or the United States mail, but obligated itself to provide one New York customer with a charge-free visit from a software installer if that customer experienced problems within sixty days of the installation of the software and incurred other travel expenses within New York when its employees visited VIP's New York customers for other hardware and software troubleshooting. The Court of Appeals of New York found these activities sufficient to demonstrate that VIP had more than a slightest presence in New York, stating, "[t]here was ample support in the record for the State Tax Appeals Tribunal's finding that VIP's troubleshooting visits to New York vendees and its assurances to prospective customers that it would make such visits enhanced sales and significantly contributed to VIP's ability to establish and maintain a market for the computer hardware and software it sold in New York." *Id.* at 181. Thus, in the instant case, the tribunal erred in limiting its focus only to whether petitioner conducted sales activities, or solicitations, in the sales destination states pursuant to its application of the *Orvis* test.

Petitioner has submitted further support for its position that the tribunal operated under a fundamental misinterpretation of *Magnetek* when it decided this matter. Revenue Administrative

Bulletin 1998-1, which respondent approved on February 24, 1998, concerns "the jurisdictional standard to determine whether a taxpayer is subject to tax under Michigan's Single Business Tax or is subject to tax in another state for purposes of apportionment under the Single Business Tax Act" and reflects respondent's positions as they relate to single business tax application to out-of-state sales.[2] RAB 1998-1 provides, as pertinent:

> I. An out-of-state business is subject to Michigan's single business tax jurisdiction when it engages in any of the following activities:
>
> * * *
>
> 6) It regularly and systematically conducts in-state business activity through its employees, agents, representatives, independent contractors, brokers or others acting on its behalf, whether or not these individuals or organizations reside in Michigan.
>
> (a) Regular and systematic business activity exists if at least 10 days of business activity occurs in Michigan on an annual ("annual" meaning a 12 month taxable year) basis;
>
> (b) Regular and systematic business activity may exist depending on the facts and circumstances of the taxpayer if less than 10 days of business activity occurs in Michigan on an annual ("annual" meaning a 12 month taxable year) basis.
>
> (i) When examining the facts and circumstances of in-state business activity, conducting any of the following activities in the State of Michigan for 2 or more days on an annual basis will be rebuttably presumed to constitute regular and systematic business activity;
>
> (1) Soliciting sales;
>
> (2) Making repairs or providing maintenance or service to property sold or to be sold.
>
> (3) Collecting current or delinquent accounts related to sales of tangible personal property through assignment or otherwise;
>
> (4) Installing or supervising installation at or after shipment or delivery;
>
> (5) Conducting training for employees, agents, representatives, independent contractors, brokers or others acting on its behalf, or for customers or potential customers;

(6) Providing customers any kind of technical assistance or service including, but not limited to, engineering assistance, design service, quality control, product inspections, or similar services;

(7) Investigating, handling, or otherwise assisting in resolving customer complaints;

(8) Providing consulting services; or

(9) Soliciting, negotiating, or entering into franchising, licensing, or similar agreements.

(ii) Conducting any of the activities listed in 6)(b)(i) in the State of Michigan for 10 days or more will constitute regular and systematic business activity.

* * *

7) If none of the business' activities in Michigan fall under paragraph 6)(b)(i) and its only contacts with Michigan are limited to conducting any of the activities listed below for less than ten days, such contacts will be presumed not to create nexus. If an activity is listed in (a) through (e) below but also is described under paragraph 6)(b)(i), then paragraph 6)(b)(i) shall control. If a business' only in-state activity is listed in 7)(f) such activity shall not be considered as solicitation for the purposes of paragraph 6)(b)(i). Conducting any of the activities listed below for more than ten days will not necessarily create nexus. Whether nexus has been created will depend on the facts and circumstances of the in-state business activity.

(a) Meeting with in-state suppliers of goods and services;

(b) In-state meeting with government representatives in their official capacity;

(c) Attending occasional meetings (e.g., Board meetings, retreats, seminars and conferences sponsored by others, etc.);

(d) Holding recruiting or hiring events;

(d) [sic] Advertising in the state through various media;

(e) Renting to or from . . . in-state entity lists; or

(f) Attending and/or participating at a trade show at which no orders for goods are taken and no sales are made.

II. The same standards used to determine nexus for out-of-state taxpayers, as described in paragraph I above, will be applied to determine whether a taxpayer is taxable in another state for purposes of apportionment under the single business tax. For purposes of Michigan's throwback rule, "nexus" in other states must be documented and will be subject to verification by the Department of Treasury. [RAB 1998-1, pp 2-4.]

Clearly, respondent, at least since February 1998, has not considered a showing of two weeks' worth of solid sales efforts as necessary to establish a taxable nexus with a sales destination state. Accordingly, we reverse the decision of the tribunal.

Finally, respondent argues that the tribunal's decision was correct because the evidence petitioner used to establish its presence in sales destination states was woefully inadequate and unbelievable. Nevertheless, we refrain from undertaking a review of the tribunal's factual findings at this time. It is apparent that the tribunal's decision was affected by its misunderstanding of the *Magnetek* decision. On remand, the tribunal shall make explicit findings on exactly how many times petitioner's sales representatives visited the sales destination states for each tax year at issue, determine the nature of the visits to these states, and, using the correct *Magnetek* standard, rule on the sales throwback issue concerning each sales destination state for each tax year. It is very likely that the tribunal will reach different conclusions on remand regarding the sales throwback issue.

Reversed and remanded for proceedings consistent with this opinion. We do not retain jurisdiction.

/s/ Jane E. Markey
/s/ Gary R. McDonald
/s/ E. Thomas Fitzgerald

[1] The *Magnetek* plaintiff also sold its products in sales destination states through independent sales representatives located within those states. *Magnetek*, *supra* at 403. This Court found that economic activities performed in the sales destination states by the plaintiff's independent sales representatives were sufficient to demonstrate more than a slightest presence within the sales destination states. *Id.* at 412. Likewise, in the case at hand, the tribunal found that petitioner demonstrated that it had more than the slightest physical presence in New York and New Jersey because it commissioned an independent contractor who resided permanently in New Jersey and maintained an office in New York and serviced three of petitioner's customers year-round.

[2] We acknowledge that an agency's interpretation of law has no binding effect on this Court. See *Clonlara, Inc v State Bd of Ed*, 442 Mich 230, 240-241; 501 NW2d 88 (1993).